

February 19, 2016

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Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations; Regulatory Capital Deduction for Investments in Unsecured Debt of Systemically Important U.S. Bank Holding Companies (Docket No. R-1523 and RIN 7100 AE-37)

Dear Mr. Frierson:

HSBC North America Holdings Inc. ("HNAH"), on behalf of itself and its parent company, HSBC Holdings plc, and its affiliates worldwide (collectively, the "HSBC Group" or "Group"), appreciates the opportunity to comment on the recent proposal (the "Proposed Rules") by the Board of Governors of the Federal Reserve System (the "Board") that would apply total loss-absorbing capacity ("TLAC") requirements to systemically important US bank holding companies ("Covered BHCs") and intermediate holding companies ("Covered IHCs") of systemically important foreign banking organizations ("FBOs").¹

I. EXECUTIVE SUMMARY

The HSBC Group recognizes the important role that TLAC can serve in ensuring that systemically important institutions have sufficient financial resources to facilitate an orderly resolution. However, we believe the Board should consider the following points when finalizing the TLAC rules:

- HNAH is a stand-alone US Covered IHC and operates through several wholly owned US domiciled and regulated entities with the same capital, liquidity and governance requirements as any other BHC and nationally chartered bank.
- The Proposed Rules' requirements for each Covered IHC to issue TLAC solely to its parent will create dependencies between HSBC Group in the US and the wider Group which may prejudice the implementation of a Multiple Point of Entry ("MPoE") resolution strategy. As such, we respectfully suggest the Board should allow Covered IHCs with a proposed MPoE resolution strategy to issue TLAC to third parties.

¹ 80 Fed. Reg. 74926 (Nov. 30, 2015).

- HNAH's operations are small in scale, both in the context of the key Global Systemically Important Banks ("G-SIBs") in the US as well as the wider HSBC Group. As such, we believe it does not pose a systemic risk to US Financial Stability. Essentially, HNAH is economically analogous to regional US BHCs which are not subject to any TLAC requirements, but which lack the potential for additional parent support to which HNAH has access. The Board should also retain flexibility to adjust both total TLAC and long term debt ("LTD") to reflect the relative importance of the US operations of a FBO to the US Financial Stability.
- Under any circumstances, the requirements for a contractual conversion trigger and the inclusion of an explicit subordination clause are not justified. They are only applied to Covered IHCs and not Covered BHCs, but they pose the material risk of the instruments being treated as equity for tax purposes, instead of debt. We urge the Board to harmonize the LTD eligibility criteria between Covered IHCs and Covered BHCs in order to achieve the goal of consistent national treatment.

II. OVERVIEW

The HSBC Group participated actively in discussions with supervisors and regulators around the world as the Financial Stability Board ("FSB") was developing its final FSB principles (the "FSB Principles"),² and provided detailed comments on the draft proposals released by the FSB in November 2014.³ In those comments and discussions, among other things, we have consistently emphasized the need for the final FSB Principles, and their individual implementations by FSB members, to recognize different business models and to accommodate resolution strategies based on a MPoE approach.

Since the Proposed Rules were released, we have also been active participants in the preparation of the comment letters by the Institute of International Bankers ("IIB" and such comment letter, the "IIB Comment Letter") and the joint comment letter filed by the Securities Industry and Financial Markets Association ("SIFMA") and The Clearing House Association LLC. ("TCH" and such letter, the "TCH/SIFMA Comment Letter"). In this letter and the attached Appendix, we focus on issues raised by the Proposed Rules of particular concern to the HSBC Group and similarly situated Covered IHCs.

Initially regulators globally were slow to recognize the resolution benefits of the HSBC Group's corporate structure of operating through independently governed, separately capitalized, locally funded, financially independent legal entities with limited interconnectedness. As the structural reform and resolution planning agenda has developed, however, regulators in the US, UK, Europe and Asia have acknowledged these benefits and have taken steps to make banking groups more resilient and resolvable by requiring separable domestic operations in host countries.

Furthermore, as global resolution strategies have developed, the preferred resolution strategies of many G-SIBs incorporate components that are consistent with both the MPoE and Single Point of Entry ("SPoE") approaches. This evolution acknowledges that G-SIBs have different business models and operations, and effective resolution strategies likely must comprise a blend of the features of both the SPoE and MPoE approaches. The FSB's requirement to pre-position internal TLAC to enable a G-SIB's material subsidiaries to be recapitalized emphasizes that resolution strategies are not sharply divided between wholly MPoE or wholly SPoE approaches.

² FSB "Principles on Loss-absorbing and Recapitalization Capacity of G-SIB in Resolution, Total Loss-absorbing Capacity (TLAC) Term Sheet" (Nov. 15, 2015).

³ FSB, "Adequacy of loss-absorbing capacity of global systemically important banks in resolution" (Nov. 10, 2014).

The HSBC Group supports a framework for TLAC as an important tool in improving global resiliency and resolvability, and agrees that FBOs and other financial institutions should have a resolution plan and sufficient resources to support orderly resolution. However, the Proposed Rules do not currently include the flexibility necessary for the Board and other US authorities to be able to recognize properly the differences between banking groups with different company structures, funding models and resolution strategies. Where a G-SIB issues its TLAC to the market, whether at a top holding company level, the Covered IHC, or both, should be aligned with the preferred resolution strategy for that G-SIB. This should not be the factor that defines the preferred resolution strategy. In particular, we believe flexibility is necessary where the regulators of a group, such as HSBC Group, pursue a MPoE strategy based on local resolution of a number of key entities within the Group.

In our view, the Proposed Rules are inconsistent with the principle of national treatment, are inconsistent with the US regulatory requirements for the current resolution plan for HSBC Group's US operations and would impose undue costs on Covered IHCs. We believe the Board should consider the following principles:

Policy Principle 1. The Board should adopt final TLAC rules that provide flexibility to apply resolution strategies, such as the MPoE strategy, agreed with home country supervisors and tailored to the structure, operations, and resolution planning of individual FBOs.

- In order to achieve the most effective resolution approach, we recommend that the Board retains flexibility to tailor the TLAC requirements to specific Covered IHCs to best achieve the Board's stated goal of "improving the resolvability and resiliency" of US banking organizations and G-SIBs. In particular, the Board should develop final rules that allow Covered IHCs the flexibility to be resolved as domestic financial companies in the US under a MPoE strategy. This would mean, inter alia, the flexibility to issue TLAC to third parties as well as to their parent FBOs. This is imperative at present when resolution strategies, whether SPoE or MPoE are unproven, and in the case of SPoE strategies, heavily dependent on cross-border cooperation between regulators and central banks whose interests are not necessarily aligned as they are mandated to protect national interests and/or depositors. Resolution strategies for all banks are also heavily reliant on further fundamental developments in a number of areas. Perhaps the most critical further developments required are the structures for liquidity provision in resolution.
- As it currently stands HSBC Group's business in the US is relatively immune from uncertainties around the adoption of resolution strategies and more generally appears to be readily resolvable due to: i) its structure of operating in the US through local legal entities owned by a US IHC and having no material foreign branches, ii) its small scale both in the context of the US G-SIBs as well as the wider HSBC Group, and iii) its limited financial dependencies on the wider HSBC Group. In view of the above, the HSBC Group is confident that HSBC Group's US operations are able to be resolved on a rapid and orderly basis. On-going improvements in the very near future will only enhance this position. The requirement under the Proposed Rules for each Covered IHC to issue TLAC solely to its parent will create dependencies between HSBC Group in the US and the wider Group thereby prejudicing one of the virtues of HSBC Group's current structure. It should also be noted that in the context of G-SIB resolution planning more generally, a key focus is on reducing a G-SIBs cross-border and intra-group dependencies rather than increasing them.

Policy Principle 2. Pursuant to the principle of national treatment, the Board should develop final rules that treat all similarly situated domestic-owned and foreign-owned holding companies consistently without disproportionately disadvantaging FBOs.

- The TLAC and associated LTD requirements applied to Covered IHCs should be calibrated on the basis of risk to US financial stability rather than on the basis of global operations and should be set so as not to disadvantage FBOs versus US banks. HNAH has very limited potential for creating any systemic concerns for US financial stability due to the relative simplicity and size of these US operations⁴.
- The harmonization of US LTD eligibility criteria between Covered IHCs and Covered BHCs would serve to achieve the goal of consistent national treatment. In particular, the requirement for a contractual conversion trigger and the inclusion of an explicit subordination clause are required only for Covered IHCs and not for Covered BHCs and pose the additional material risk of the instruments being treated as equity for tax purposes for IHCs, instead of debt. As a result, interest payments on such instruments would not be deductible for tax purposes imposing a direct and significant financial penalty on IHCs of FBOs as compared to US G-SIBs.

Certain elements of the Proposed Rules appear to be inconsistent with these key principles. In their current form the Proposed Rules would impose unnecessary constraints on the potential resolution plans of the HSBC Group and particularly the implementation of an effective MPoE strategy, while requiring TLAC requirements that are not associated with a concomitant benefit to US financial stability.

If the Board does not set requirements commensurate with the risk that an institution poses to the US, we believe that the Board will introduce an uneven playing field in the domestic US markets. At present, there is a danger that the non-systemic US subsidiaries of G-SIBs could face a substantially different regime for loss absorbency when compared to banks of a similar nature that are US-owned. This should be considered a “wrong-way” incentive because in many ways HNAH is economically analogous to its US peer firms that have zero TLAC requirements⁵, but lack the additional parent support to which HNAH has access.

III. BACKGROUND ON HSBC GROUP

HSBC Group’s Resolution Strategy

The proposed HSBC Group resolution strategy is based on the resolution of regional or national groups of affiliated companies in a MPoE approach. This provides for HSBC Group to be resolved by reference to its three main resolution hubs of the UK, US and Hong Kong with the applicable national regulator leading the resolution of each hub site and its domestic and overseas subsidiaries. The HSBC Group’s external TLAC would be issued by each of the hub sites to the market to provide the local regulator with the means of carrying out a bail-in to recapitalize the hub without involving the remainder of the HSBC Group or requiring co-operation with other regulators.

The Proposed Rules distinguish between IHCs in a limited way on the basis of whether they are resolution or non-resolution entities but do not reflect the differences between companies organized and whose regulators are planning for a MPoE approach instead of a SPoE approach.

⁴ Please refer to Figure 1 below.

⁵ Both in terms of size of assets and systemic risk score (please refer to Figure 1 below)

Under the MPoE approach, the US regulators have full control over the resolution of the US operations of the FBO and there is a clear path to implementation of the resolution. The MPoE approach is tailored to the IHC requirements contained in the Board's Enhanced Prudential Standards for FBOs under Section 165 of the Dodd-Frank Act (the "FBO EPS").⁶ Those requirements treat IHCs very much like US domestic BHCs with equivalent US capital, liquidity and regulatory standards. For FBOs such as HSBC Group, that are structured to conduct independent US operations and whose regulators are considering a MPoE approach, these IHC requirements generally support their resolution strategy. The final US TLAC requirements should likewise support, and not impair, the MPoE resolution strategy consistent with FBO regulation and supervision in the US.

HSBC Group's US Operations

The structure and operations of HSBC Group in the US differ from those of many FBOs and are more analogous to those of a US BHC that is not a G-SIB. Since it acquired a majority shareholding in Marine Midland Banks, Inc. in 1980, HSBC Group has operated with HNAH as a BHC and a local bank in the US that has become increasingly self-sufficient. The US bank is a relatively simple deposit-funded bank engaging in traditional retail, commercial banking and global banking and markets activities within the US. It is geographically focused on the US with no material overseas branches and limited cross-border exposures.⁷ Moreover, unlike many FBOs, HSBC Group does not presently maintain any US branches of its foreign banking affiliates. Any US resolution would be simple and entirely contained locally. This makes HNAH more analogous to US non-G-SIB BHCs rather than to its IHC peers and we believe that the US final TLAC rules should reflect this.

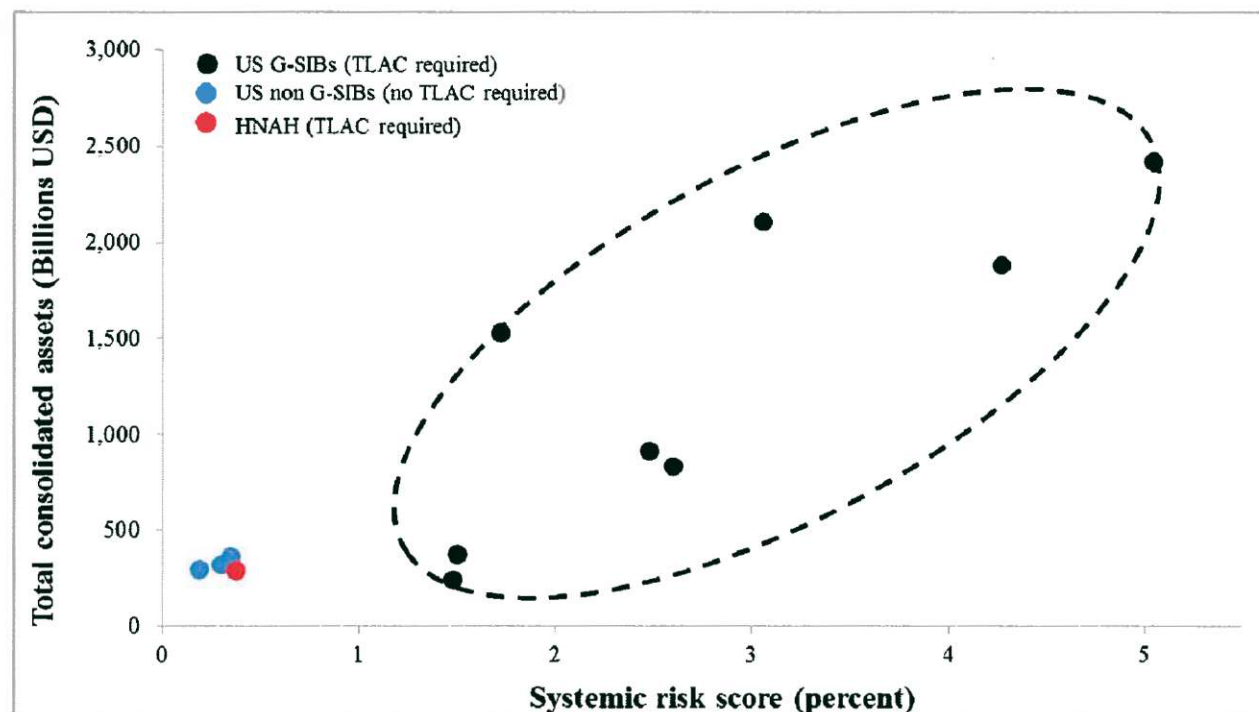
Effectively, the US operations operate on a standalone basis under the IHC, HNAH, focused on financing US customers and activities with limited cross-border exposures as evidenced in the FR Y-15. This is demonstrated by HNAH's systemic risk score which is consistent with that of US regional banks according to a February 2015 paper published by the Office of Financial Research (the "OFR Brief"). The following figure compares HNAH to the eight US G-SIBs and to some of its US peer institutions (US Bancorp, PNC and Capital One) on the basis of total consolidated assets as of December 2013 and the institutions' 2013 systemic risk scores, according to data from the Board's National Information Center and Treasury's Office of Financial Research.⁸

⁶ Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations, 79 Fed. Reg. 17240 (Mar. 27, 2014).

⁷ HSBC Group reports this information on its Form FR Y-15 ("FR Y-15") submissions.

⁸ Consolidated assets are as reported on the Board's National Information Center, as of December 31, 2013. Systemic risk score data is as reported in the February 2015 paper published by the Office of Financial Research, "Systemic Importance Indicators for 33 U.S. Bank Holding Companies: An Overview of Recent Data See Office of Financial Research", at 2 (Feb. 2015), <https://financialresearch.gov/briefs/files/2015-02-12-systemic-importance-indicators-for-us-bank-holding-companies.pdf>.

Figure 1: Comparison of Consolidated Assets and Systemic Risk Scores of Selected US G-SIBs, Largest Non-G-SIB US BHCs and HNAH



Note: Consolidated assets as reported on the Board's National Information Center, as of December 30, 2013. Systemic risk score data as reported in the OFR Brief.

IV. POLICY PRINCIPLE 1

The Board should adopt final TLAC rules that provide flexibility to apply resolution strategies, such as the MPoE strategy, approved by home and host country supervisors and tailored to the structure, operations, and resolution planning of individual FBOs.

The Proposed Rules would require all Covered IHCs, including Covered IHCs that have an effective MPoE resolution strategy ("MPoE IHCs") such as HNAH, to issue TLAC and LTD solely to their parent FBOs (the "Internal Issuance Requirement"). This requirement is fundamentally inconsistent with a MPoE resolution strategy for the Covered IHC irrespective of the FBO's corporate structure or the FBO's home country, crisis management group ("CMG") and FBO resolution strategy. As a consequence, the Proposed Rules ignore the resolution strategies approved by home and host country supervisors and being implemented by certain FBOs, while discriminating against the US operations of FBOs. In particular, the Internal Issuance Requirement will increase the concentration risks for non-deposit funding by making the Covered IHCs wholly dependent on their parent FBOs for TLAC-eligible debt funding.

The HSBC Group has worked closely with the Bank of England ("BoE"), and its CMG (which includes the Board), to develop the MPoE resolution strategy reflected in the resolution plans that HNAH submits to the Board and the Federal Deposit Insurance Corporation. A fundamental premise of HNAH's MPoE resolution strategy is that HNAH and its US operations are independent from the remainder of the HSBC Group. This independence comes from a number of sources:

- HNAH has an independent funding and liquidity model and manages its capital planning independently.

- HNAH participates in the Board's Comprehensive Capital Analysis and Review ("CCAR") and the Dodd-Frank Act Stress Test ("DFAST").
- Those requirements treat IHCs very much like US domestic BHCs with equivalent US capital, liquidity and regulatory standards
- HNAH has a service company that provides services almost solely to HSBC Group's US operations, with only limited dependencies on the non-US operations of the HSBC Group.
- The HSBC Group has no operations in the US other than those within its IHC, HNAH.⁹

HNAH is therefore more analogous in structure to certain US BHCs, notwithstanding its ownership by a FBO. It would be expected to enter domestic resolution proceedings on its own and pass any losses to its creditors through that process, under a MPoE resolution. The Proposed Rules would undermine these efforts by requiring HNAH to be directly linked to its parent FBO, which is inconsistent with a MPoE resolution strategy.

In the preamble, the Board articulates two reasons for the Internal Issuance Requirement:

- It would prevent the conversion of eligible internal TLAC into equity from effecting a change in control over the Covered IHC; and
- It would ensure that losses incurred by the Covered IHC would be upstreamed to a foreign parent rather than being transferred to other US entities.¹⁰

Although these concerns may be relevant for Covered IHCs pursuing a SPoE resolution strategy where the US operations remain fundamentally dependent upon their foreign parent, in our view they are not relevant to HNAH and other MPoE-oriented Covered IHCs, where a separate resolution of the US operations is envisaged and arrangements have been put in place to facilitate this. Requiring all TLAC (including LTD) to be issued solely to the FBO parent potentially transforms the resolution strategy into a SPoE strategy, transferring all losses to HSBC Group and rendering redundant the resolution planning and adjustments undertaken by HNAH.

- The Board states that a possible change in control raises a concern that it would "create additional and undesirable regulatory and management complexity during a failure scenario and would severely disrupt an SPoE resolution strategy."¹¹ HNAH has already developed a domestic MPoE resolution strategy that ensures HNAH can be resolved in an orderly fashion as a stand-alone entity. Furthermore, the Internal Issuance Requirement ultimately means the resolution of the IHC at the foreign parent level and if financial resources at the parent have been depleted in the recovery phase (as would be expected) this increases the risk of a change of control at the foreign parent level, rather than at a local level. With US investors focused on the health of the US operations, rather than at a Group level, the Board may prefer that any change of control of the IHC occurs in the US under its direct control.

⁹ See "Structure Data for the U.S. Offices of Foreign Banking Organizations" (Board, Sept. 30, 2015), <http://www.federalreserve.gov/releases/iba/201509/bycntry.htm>.

¹⁰ 80 Fed. Reg. at 74941-42.

¹¹ 80 Fed. Reg. at 74942 (emphasis added).

- While the Board expresses concerns about potential transfers of losses to other US entities, given the limited potential for risk to US financial stability resulting from HSBC Group's US operations, these concerns do not apply to HSBC Group. The approach to be used for the domestic resolution of a Covered IHC should reflect the capital, liquidity and risk management requirements imposed on IHCs as well as the explicit structural subordination that insulates the operating banks. Both of these precisely mirror the US BHC model that is itself designed to reduce risks to financial stability. And HSBC Group's US operations are of a much smaller scale than many US BHCs, particularly the US G-SIBs. As indicated in section II.B.1 of the Appendix, as of 31 December 2014, HNAH's consolidated assets were \$290bn compared to average consolidated assets of \$1,286bn of average assets for the eight US G-SIBs. Perhaps most importantly, HNAH's systemic risk score was 0.38 versus 2.77 average score for the eight US G-SIBs.¹² So we do not believe that the requirement that all MPoE IHCs must issue all TLAC internally can be justified on the basis of the threats to US financial stability.
- Conversely, the internal TLAC requirements would potentially introduce a funding dependency into HNAH by creating direct links to its parent FBO as a source of funding and liquidity and eliminating the option of directly accessing alternative sources. This would contradict the important risk management and supervisory goal of diversifying funding by increasing the funding dependency of Covered IHCs as discussed, for example, in inter-agency guidelines.¹³
- The Internal Issuance Requirement and the resulting exportation of losses to the non-US parent of a FBO further deviates from the normal principle that losses should be borne by those entities, and addressed by those resolution authorities, with the capability and responsibility for preventing or managing the losses. The relative responsibilities of consolidated supervisors and host country supervisors are based on their comparative scope of oversight for the entities within their purview. If losses are exported to the non-US parent when the home country, and the FBO, have structured the operations in the host country to achieve a MPoE resolution strategy, it will be inconsistent with the supervisory and resolution relationships between the home and host countries. This may be seen as an unjustified imposition, creating unnecessary financial contagion and contrary to the relative responsibilities of home and host countries in a way which is, at best, unhelpful and, at worst, creates poor incentives. Moreover, the exportation of losses from the host country exclusively to the home country may imply that the home country regulations should have greater control over the host country operations since the home country must bear the consequences of any failure of regulatory or supervisory oversight in the host country. An example of this is the draft EU proposals for Bank Structural Reform ("EU BSR") that could affect HSBC Group's US operations if TLAC must be issued to the EU parent company, a degree of extra-territoriality that could be avoided if external TLAC issuance was permitted.
- The Proposed Rules require all eligible TLAC to be issued exclusively by the Covered IHC. The Board may wish to retain flexibility to permit the US operations of FBOs to issue external TLAC both from the Covered IHC or another US holding company as appropriate to achieve the most effective and efficient resolution strategy for the FBO's US operations.

¹² Consolidated assets are as reported on the Board's National Information Center, as of December 30, 2013. Systemic risk score data is as reported in the February 2015 paper published by the Office of Financial Research, "Systemic Importance Indicators for 33 U.S. Bank Holding Companies: An Overview of Recent Data" <https://financialresearch.gov/briefs/files/2015-02-12-systemic-importance-indicators-for-us-bank-holding-companies.pdf>

¹³ Board Supervision & Regulation Letter SR 10- 6 Interagency Policy Statement on Funding on Liquidity Risk Management (Mar. 17, 2010), Fed. Banking L. Rep CCH ¶48-454 (seeking to limit the concentration of funding from a single counterparty).

The Internal Issuance Requirement would be contrary to HSBC Group's resolution strategy as proposed by the BoE and HSBC Group's CMG and which HNAH has taken significant steps to support. Allowing the FBO to issue external TLAC would allow the Board, and HSBC Group, to tailor the TLAC requirements to the most effective, and efficient, resolution strategy for HSBC Group, and other similarly structured FBOs. As such, we respectfully urge the Board to adjust the Internal Issuance Requirement and allow Covered IHCs with a proposed MPoE resolution strategy to issue TLAC to third parties.

V. POLICY PRINCIPLE 2

Pursuant to the principle of national treatment, the final rules should base any TLAC requirements applied to Covered IHCs on the potential risk that the Covered IHC poses to US financial stability, and treat all similarly situated domestic-owned and foreign-owned holding companies consistently and without disproportionately disadvantaging FBOs.

The Proposed Rules conflict with the principle of national treatment in several fundamental respects:

- The proposed internal TLAC and LTD requirements bear no relationship to the systemic risk to the US financial system potentially posed by Covered IHCs, and discriminate against Covered IHCs compared to US domestic BHCs with similar systemic significance based solely on the ownership of Covered IHCs by FBOs.
- By applying the G-SIB methodology under the Basel Committee on Banking Supervision assessment methodology to determine whether a FBO's US operations must comply with the Internal TLAC and LTD requirements, the Board focuses on the FBO's global presence rather than the potential risks that the FBO's US operations pose to US financial stability (for example, as set out in FR Y-15 submissions). This has no relation to the US operations and discriminates against IHCs compared to BHCs by sweeping within the Proposed Rules Covered IHCs with minimal or no potential for creating risks to US financial stability.
- The eligibility criteria for internal LTD are more onerous for Covered IHCs than for Covered BHCs, in particular the contractual conversion trigger and explicit subordination provisions. This poses the additional material risk of the instruments being treated as equity for tax purposes for IHCs, instead of debt as would be the case for external LTD issued by US BHCs.

MPoE IHCs would have to maintain internal TLAC and LTD at levels that are essentially equivalent, or higher, to those of much larger Covered BHCs. This discriminates against FBOs in their operations in the US compared to non-G-SIB US and fails to recognize that US TLAC requirements, under the FSB Principles, should address only the risk posed by the FBO's US operations to the US financial system.¹⁴ In the preamble, the staff of the Board explains that: The rationale for the internal TLAC requirements is "generally parallel to the rationale for the proposed external TLAC and LTD requirements."¹⁵

However, in setting the internal TLAC and LTD requirements at the same or higher level, the Board has equated the systemic risk that MPoE IHCs pose to US financial stability to that posed by Covered BHCs.

- We disagree with this premise and believe that the Board should evaluate the risks posed by MPoE IHCs on a stand-alone basis apart from the global operations of the FBO. As indicated

¹⁴ See FSB Principles at 17 (Term Sheet item 16).

¹⁵ 80 Fed. Reg. at 74940.

under Section IV above, HNAH is a stand-alone US Covered IHC for capital and liquidity and regulated by the Board.

- This is particularly appropriate for the HSBC Group, which has taken significant steps to make its US operations independent from its global operations. As noted above, HSBC Bank USA, National Association (“HBUS”) is deposit-funded, engages in traditional retail and commercial banking within the US, and is regulated by the Office of the Comptroller of the Currency (“OCC”) as is the case for other national chartered US banks. As a result, the implementation of HNAH’s resolution strategy, which was developed in consultation with the BoE and HSBC Group’s CMG (which include the Board), would be straightforward and limited in geographic scope to the US.
- As a result, any systemic risk posed by HNAH is more equivalent to that of a regional non-G-SIB US BHC than a Covered BHC.
- Under the principle of national treatment, the Board should not differentiate between Covered IHCs and similarly situated non-G-SIB US BHCs. Since the Board has decided that such US BHCs should not be subject to any minimum TLAC requirements, the same should apply to HNAH. Instead, however, the Proposed Rules would impose requirements on HNAH as though it were a Covered BHC, solely because it is owned by a FBO rather than third-party shareholders.

We recognize that, notwithstanding the above, the Board has an interest in Covered IHCs maintaining minimum levels of internal TLAC. But because Covered IHCs can differ significantly in their size and complexity, the Board should determine the appropriate levels of internal TLAC on an institution-specific basis. For Covered IHCs that are economically analogous to regional US BHCs¹⁶ and not subject to any TLAC requirements there should be a substantial reduction in the levels of TLAC required for Covered IHCs than those in the Proposed Rules, on the basis of the Covered IHC’s size, the nature of its activities, and its systemic importance to the US.

As applied to HNAH (and other similarly situated Covered IHCs), consideration of these factors should significantly reduce the required TLAC (along with any LTD required) by virtue of the simplicity of its US operations, its compliance with the segregated capital, liquidity, and risk management requirements of the FBO EPS, and its very limited potential for creating any systemic concerns for US financial stability.

A. The Board Should Apply a Consistent Methodology in Determining the External and Internal TLAC Levels

The Board’s calibration of internal TLAC deviates from the methodology used to determine external TLAC because the Board does not incorporate the assumption of “balance sheet depletion” when setting the internal LTD and leverage-based TLAC requirements. For external LTD, the framework includes a reduction for anticipated balance-sheet depletion¹⁷ within the “capital refill” framework but the Board does not include a similar reduction for internal LTD and does not give any reason for the disparate treatment of Covered IHCs. As a result, Covered IHCs would be subject to stricter LTD requirements based solely on the fact that they are FBO subsidiaries. The Board should apply a uniform methodology when setting external and internal requirements. Failure to do so would subject Covered IHCs to unfair treatment and impose requirements that are above what the Board’s own stated rationale should require.¹⁸

¹⁶ See Figure 1 above.

¹⁷ 80 Fed. Reg. at 74933.

¹⁸ 80 Fed. Reg. at 74941.

Notwithstanding the above, we also support the arguments expressed in the IIB Comment Letter¹⁹ and the TCH/SIFMA Comment Letter²⁰ that the Board eliminate a minimum LTD component altogether.

B. The Board Should Conform the Eligibility Requirements for Internal LTD with Those for External LTD

As we discuss in Section III above, the final TLAC rules should allow a MPoE IHC to issue TLAC to third parties as well as to its affiliates on the same basis as a Covered BHC. However, if the Board were to retain the Internal Issuance Requirement, we believe the Board must eliminate the current differences in the eligibility criteria for eligible internal LTD and eligible external LTD since:

- Issuing TLAC/LTD results in an increase in the cost of funding versus senior unsecured debt. However, the additional eligibility criteria for internal TLAC/LTD for Covered IHCs such as the contractual conversion trigger and the subordination provisions will further increase the cost of issuance as compared to that of Covered BHCs, which are not subject to such requirements.
- These requirements are unnecessary to improve the resolvability of FBOs that have established effective stand-alone operations in host jurisdictions and add no benefits for systemic financial stability and are therefore difficult to justify.
- The requirements violate the principle of national treatment.
- The effects would be concentrated solely in FBOs and could, therefore, be considered prejudicial to the treatment of foreign-owned firms under international arrangements.

The HSBC Group has analyzed the effects that the features below would have on the cost of a material portion of the existing senior unsecured debt issued by its US affiliates and has concluded that those costs would increase for the following reasons:

- Contractual Conversion Trigger.²¹ The Proposed Rules require that eligible internal LTD must contain a “contractual conversion trigger” feature allowing the Board to require a Covered IHC to cancel the internal LTD or convert it to common equity Tier 1 upon certain conditions prior to resolution. This feature is not standard and would not be included in external TLAC issued by Covered BHCs. It would significantly increase the cost of internal LTD for Covered IHCs:
 - If the contractual conversion trigger is retained, the Covered IHCs will bear a higher cost for these features because they must transact with their FBO parent on arms-length terms.
 - The contractual conversion trigger introduces the material risk of adverse and inequitable tax consequences for internal LTD relative to external LTD, creating an asymmetry between IHCs and BHCs. This would impose a direct and significant financial penalty on FBOs as a result of the non-deductibility of the interest payments and a dis-incentive to investment in the US operations. It is vital that the US authorities address the tax treatment of internal LTD, either by modification of the proposed terms or the issuance of formal, unequivocal confirmation from the US Treasury and Internal Revenue Service, to

¹⁹ IIB Comment Letter, Section III.

²⁰ TCH/SIFMA Comment Letter Annex 1, Section II.A.

²¹ See 80 Fed. Reg. at 74937.

ensure that internal LTD will be treated as debt for tax purposes, as would be the case for Covered BHCs.

- Restructuring of Tier 2 Instruments. Restructuring all existing Tier 2 debt instruments issued by HSBC Group's US entities to include contractual conversion triggers would cause HNAH and its parent to incur material costs, especially as Tier 2 instruments have generally longer maturities.
- Contractual Subordination. The preamble to the Proposed Rules implies that internal LTD should include a contractual subordination provision whereas Covered BHCs are specifically not required to include such feature. This could increase the cost of LTD, but is not necessary for a MPoE IHC that is expected to enter resolution proceedings independent of its parent FBO.
- Concentration of Funding Sources. The Proposed Rules would require Covered IHCs to rely on their parent FBOs as the sole source of funding and liquidity. This concentration of funding sources could potentially increase funding costs, particularly if there are wider constraints on funding from the Group, despite the availability of good sources of local external funding.

VI. TIMING CONSIDERATIONS

If the Board does not modify the final TLAC rules in line with the policy principles we have articulated above, or if they do not allow existing instruments to count towards internal LTD, we believe that the compliance timetable in the Proposed Rules will impose significant challenges for Covered IHCs. Even once final rules are released, firms will require time to address interpretative issues from the final rules and devise a strategy for compliance. In addition, Covered IHCs will have to amend their existing capital structure to be in compliance. Considering the magnitude of these changes, we believe the Board should retain flexibility in the time that Covered IHCs will have to comply with any final rules in order to make adjustments for circumstances related to specific institutions or changing market conditions.

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We would be pleased to provide further information or assistance to the Board or its staff. Please contact the undersigned or John S. Cassidy, Senior Legal Counsel, if we can provide any additional information.

Sincerely,



Gerard Mattia
Chief Financial Officer
HSBC North America Holdings Inc.

cc: Iain Mackay, Patrick Burke, Bryan Pascoe, Stuart Alderoty, James Chew, Richard Hennity, Kevin Fromer

APPENDIX

I. BACKGROUND

A. Structure of the HSBC Group

The HSBC Group comprises of a number of separate locally incorporated banks and other subsidiaries operating across the globe, under a number of holding companies predominantly owned by HSBC Holdings plc, the ultimate parent company that is incorporated in the UK. The majority of these banks operate either substantially or wholly within the jurisdiction within which they are incorporated, with limited cross-border branching. These banks satisfy domestic capital, liquidity and funding requirements (as applicable) and have the independent resources to respond to financial stress. Transactions between affiliates are undertaken on an arms-length basis, with contractual terms and collateral as required and shared operational support will soon be delivered from stand-alone service companies on an arms-length basis. This results in a series of relatively autonomous banks and holding companies acting under the umbrella of the HSBC Group. Subsidiary banks have their own boards, generally including non-executive directors, and these local boards and management are responsible for the activities and risks of the relevant entity within the framework and requirements established by the Group.

B. Group Resolution Strategy

We have been working with the BoE, the U.K Prudential Regulation Authority (“PRA”) and our other primary regulators to develop a resolution strategy for HSBC Group. In view of the structure of the HSBC Group a resolution strategy whereby the Group breaks up at a subsidiary bank level at the point of resolution (i.e., a MPoE strategy) rather than being kept together as a group at the point of resolution (i.e., a SPoE strategy) is the optimal approach.

In common with all G-SIBs, we are working with our regulators to understand interdependencies between different businesses and subsidiary banking entities within HSBC Group in order to enhance resolvability. We have initiated plans to mitigate or remove critical inter-dependencies to further facilitate the resolution of HSBC Group. In particular, to remove operational dependencies (where one subsidiary bank provides critical services to another), we are in the process of transferring such critical services from the subsidiary banks to a separately incorporated group of service companies (“ServCo group”). The ServCo group will be separately capitalized and funded to ensure continuity of services in resolution. A significant portion of the ServCo group already exists and therefore this initiative involves transferring the remaining critical services still held by subsidiary banks into the ServCo group. The services will then be provided to the subsidiary banks by the ServCo group.

C. HSBC Group’s US Operations

1. Nature and Scale

Unlike many FBOs operating in the US, the HSBC Group does not currently maintain any US branches or agencies of its foreign banking affiliates. HSBC Group conducts its US banking activities through two separately organized, Federal Deposit Insurance Corporation-insured national banks. Those banks are indirectly wholly owned by HNAH, an existing US BHC that also serves as the top tier US intermediate holding company for all of HSBC Group’s existing US subsidiaries. As of December 31, 2014, the total assets of HNAH were \$290bn. The great majority of HSBC Group’s banking operations are conducted through HBUS.

The non-bank subsidiaries of HNAH are HSBC Markets (USA) Inc. (“HMUS”), a holding company for the firm’s US broker dealer, HSBC Finance Corporation, an entity holding certain run-off consumer finance businesses, and HSBC Technology & Services (USA) Inc. (“HTSU”), a provider of information technology and centralized operational and support services including human resources, tax, finance, compliance, legal, corporate affairs and other services shared among the subsidiaries of HSBC North America and the HSBC Group.

HBUS is held through HSBC USA Inc. (“HUSI”), its direct parent and an indirect subsidiary of HNAH. HUSI had total consolidated assets of \$186bn as of December 31, 2014. HUSI has filed an effective shelf registration statement with the Securities and Exchange Commission (“SEC”) for the issuance of debt securities, preferred stock, depository shares, warrants, purchase contracts and units. HSBC Group has had a banking presence in the US since 1875, but the current banking operations derive largely from the acquisition of Marine Midland Banks, Inc. progressively from 1980 with the addition of further banking operations with the acquisition of the Republic National Bank of New York in 1999. HBUS serves corporate, commercial and personal customers across the US although its branch footprint is concentrated in New York with 145 branches and in a limited number of cities across 10 states with 83 branches as at December 31, 2015.

HSBC Securities USA Inc. (“HCSU”) is the broker-dealer for the HSBC Group in the US and had total assets of \$81bn as of December 31, 2014. HCSU is registered broker of securities under the Exchange Act and a registered Futures Commission Merchant with the Commodity Futures Trading Commission. It generally leads or participates as underwriter of all HUSI domestic issuances of term debt and, historically, HSBC Finance Corporation issuances of term debt and asset-backed securities.

In 2002, the HSBC Group acquired Household Finance Corporation and it retains these operations as HSBC Finance Corporation, although these assets are in accelerated run-off. As at December 31, 2014, HSBC Finance Corporation had \$32bn of assets, of which \$21bn were Net Receivables and in June 2015, the entity expanded the receivables sales program which resulted in the transfer of \$11bn of receivables (including accrued interest) to held for sale. It is expected that, by the time that HNAH must meet the TLAC requirements on January 1, 2019, these operations would have shrunk considerably.

The HSBC Holdings plc consolidated total assets as at December 31, 2014, presented in accordance with IFRS accounting standards, was \$2,634bn, which highlights the scale of the US business (\$290bn on US GAAP basis) relative to HSBC Group. To summarize and as detailed in Figure 2 below, the US entities operate as a series of local entities under a US holding company, HNAH, which acts as the IHC in the US as required by the FBO EPS. However, the HSBC Group’s US operations have operated as a BHC since the 1980s and therefore HNAH is in many ways analogous to a US BHC.

2. Capital and Funding Strategy

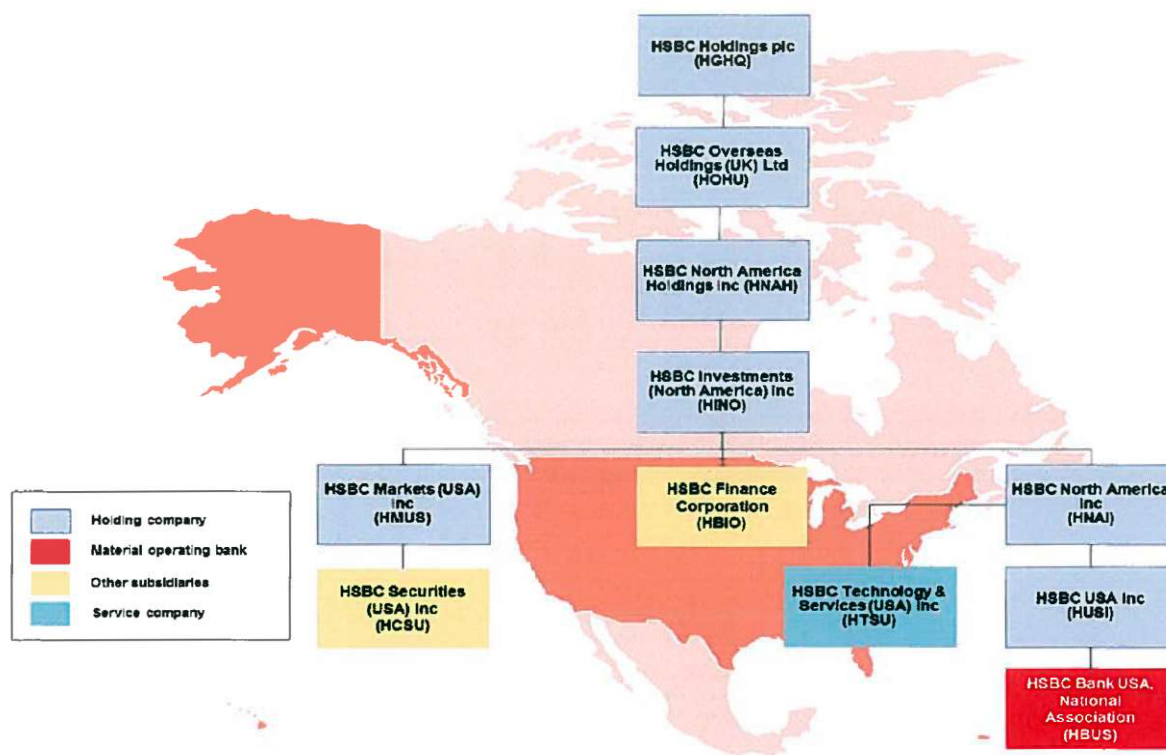
The US operations have a diverse range of funding sources, both internal and external, which vary between the different entities.

HNAH’s shareholders’ equity includes common stock and preference shares that have been issued within HSBC Group. HNAH’s Tier 2 capital resources include subordinated debt issued to HSBC Group and to third parties by HUSI, HBUS and HSBC Finance Corporation. It is important to note that HSBC Group has provided continued support to maintain appropriate levels of capital and in particular has historically provided significant capital in support of HSBC Finance Corporation’s operations.

The organizational structure of HSBC Group’s US operations is provided in Figure 2 below. The primary sources of funding across the Group are derived within each of the material entities under HNAH:

- HUSI's primary sources of funding are commercial paper issued to third-party investors and debt issued to both HSBC Group entities and third parties.
- HBUS's primary source of funding is its deposit base and it supplements this source of funding by issuing short-term and long-term debt in the external market, including through a 3(a)(2) program and borrowing under unsecured and secured financing facilities, selling liquid assets and receiving capital contributions from its immediate parent, HUSI.
- HCSU's primary source of funding is the US repo market. In order to satisfy the need for unsecured funding, HCSU also has access to committed and uncommitted unsecured credit facilities from HSBC Group entities and third parties.
- HSBC Finance Corporation's main sources of funding are cash flows from the ongoing collections of its loan portfolio, including interest and fees. HSBC Finance Corporation's primary sources of funding in 2014 were the proceeds from sales of pools of real estate secured receivables, liquidation of short-term investments, cash generated from operations including loan payments and pay-offs, and REO sales proceeds. HSBC Finance Corporation also receives significant funding from capital contributions from HSBC Investments (North America) Inc. and funding from other HSBC Group entities. HSBC Finance Corporation previously relied, to a significant degree, on third-party funding.

Figure 2: Overview of Organizational Structure of HSBC Group's US Operations



3. US Resolution Strategy

The proposed HSBC Group's resolution strategy is based on the resolution of regional or national groups of affiliated companies in a MPoE resolution strategy. This provides for HSBC Group to be resolved by

reference to its three main resolution hubs of the UK, US and Hong Kong with the applicable national regulator leading the resolution of each hub site and its domestic and overseas subsidiaries. The HSBC Group's external TLAC would be issued by each of the hub sites to the market to provide the local regulator with the means of carrying out a bail-in to recapitalize the hub without involving the remainder of the HSBC Group or requiring co-operation with other regulators.

The HSBC Group set out the resolution strategy for its US operations in its December 2015 submission of its US resolution plans. The US resolution plans provide for the separate resolution of each material legal entity within the US Group, as required by the current US regulator-prescribed strategies and assumptions. As with previous submissions, the US resolution plans provide for the resolution of the HNAH sub-group on a national MPoE basis whereby all six of the US material entities, including HBUS and HCSU, are resolved or placed into bankruptcy proceedings on an entity-by-entity basis.

D. Section 165 of the Dodd-Frank Act and Implications for FBOs

We believe that due and careful consideration needs to be given to how minimum TLAC requirements should be applied to IHCs, considering the measures already implemented under Section 165 of the Dodd-Frank Act.²² These require, inter alia, that FBOs:

- Create an IHC as a parent for all relevant legal entities in the US;
- Generate resolution plans for these entities; and
- Meet comprehensive regulatory requirements and prudential standards.

The regulatory rules include capital requirements, liquidity requirements, semi-annual stress testing requirements, single counterparty credit limits, risk management standards, debt-to-equity limits and early remediation requirements. These requirements are analogous to those of a US BHCs, but it should be acknowledged that IHCs also have additional requirements from parent company's home jurisdictions. As a result, IHCs are some of the most heavily regulated entities in the industry. As we discuss above, from a US systemic risk perspective, HNAH is more analogous to a regional US BHC than it is to a US G-SIB. However, HNAH is subject to substantially higher levels of regulation²³ than its peer institutions. The Proposed Rules, if adopted, would only exacerbate this situation.

We believe that an approach that considers the US operations of FBOs as both (i) a stand-alone business capable of being resolved in the US, and (ii) part of a global group for the purposes of defining the TLAC required at the point of resolution would seem to be inconsistent and potentially penal, opening up a "double jeopardy" for FBOs.

II. SPECIFIC HSBC GROUP TLAC CONCERNS

Our letter above describes the key principles that we believe the Board should follow in adopting final TLAC rules and articulates issues that are of particular concern to the HSBC Group. On many issues, the HSBC Group concurs in the arguments presented in the IIB Comment Letter and the TCH/SIFMA Comment Letter. In the following discussion, we have noted specific arguments from those letters of particular importance to HSBC Group, where appropriate. In addition, we have elaborated on those issues of particular concern to HSBC Group in order to provide the Board with additional context and factual support for our recommended modifications to the Proposed Rules.

²² Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, §165 (2010).

²³ As HNAH has to solve for the more conservative of the two regulatory regimes (US and parent).

A. Policy Principle 1: The Board should adopt final TLAC rules that provide flexibility to apply resolution strategies, such as the MPoE strategy, approved by home and host country supervisors and tailored to the structure, operations, and resolution planning of individual FBOs.²⁴

The Proposed Rules would generally apply the same requirements to all Covered IHCs, with some differences in the calibration of internal TLAC and LTD based on whether a Covered IHC is a resolution entity or not. However, applying the same TLAC and LTD requirements to all Covered IHCs ignores differences between the resolution strategies of those Covered IHCs. In order to achieve the most effective resolution approaches, we recommend that the Board retain flexibility to tailor the TLAC and LTD requirements to specific Covered IHCs to best achieve the Board's stated goal of "improv[ing] the resolvability and resiliency" of US banking organizations and G-SIBs.²⁵

The Board has frequently exercised discretion to tailor its supervisory and regulatory requirements based on the perceived systemic importance of FBO's US operations to US financial stability. For example the Board, along with the FDIC, has tailored the requirements for resolution planning to reflect the potential systemic risks posed by FBO's US operations to US financial stability. Many December filers of resolution plans have significantly fewer requirements than July filers, which consist of the largest and most systemically significant US BHCs and FBOs. Similarly, the evolving resolution plans of FBOs are tailored to the resolution strategies adopted by their home and host country supervisors within limits defined by the US resolution planning rules.²⁶ Those rules do not preclude a MPoE strategy, but in fact are premised on strategies that require analysis of the separate resolution of the FBO's US material entities. It would be particularly incongruent, and inconsistent with the evolving nature of resolution strategies for the US operations of FBOs, if the final TLAC rules adopt an approach contrary to the MPoE strategies emphasized by the US resolution planning process and rules. As the Board notes in the preamble,²⁷ the Proposed Rules are complementary to an evolving process of resolution planning and other regulatory and industry efforts to improve resolvability, which the Board recognizes as an evolving process. It would be more consistent with the iterative and institution-specific nature of resolution planning that has evolved since the resolution planning rules were adopted for the Board to retain flexibility and discretion in setting TLAC requirements.²⁸

There are several important respects in which this flexibility should be used to bring the Proposed Rules in line with the work that the HSBC Group has done in recent years to improve resolvability.

1. The final TLAC rules should allow MPoE IHCs to issue TLAC to third parties as well as to affiliates²⁹

As we explain in the discussion of Policy Principle 1 above, the requirement for MPoE IHCs to issue internal TLAC solely to their parent FBOs is entirely inconsistent with the MPoE resolution strategy. If this requirement is retained, it would significantly impair the currently anticipated resolution strategy of the HSBC Group with respect to its US operations. In the preamble to the Proposed Rules, the Board

²⁴ This section is responsive to Questions 25, 27, 36, 64 and 65 in the preamble to the Proposed Rules.

²⁵ 80 Fed. Reg. at 74928.

²⁶ See 12 C.F.R. Parts 243 and 381.

²⁷ See generally, 80 Fed. Reg. at 74927-28.

²⁸ See, e.g., <http://www.federalreserve.gov/newsevents/press/bcreg/20140815a.htm>.

²⁹ This section is responsive to Questions 32 and 36 in the preamble to the Proposed Rules.

states that it views the SPoE resolution strategy as appearing to “offer substantial advantages” to the MPoE strategy, but the Board also makes clear that:

US regulators nevertheless are cognizant of the need to prepare for other plausible contingencies, including the MPOE resolution of a GSIB. While this proposal is primarily focused on implementing the SPOE resolution strategy, it would also substantially improve the prospects for a successful MPOE resolution of a GSIB by requiring US GSIBs and the IHCs of foreign GSIBs to maintain substantially more loss-absorbing capacity.³⁰

However, as a result of the Internal Issuance Requirement, rather than facilitate a MPoE resolution, the Proposed Rules would effectively eliminate it as a viable option – even though in other contexts, the Board has recognized MPoE as a valid and separate resolution strategy. For example, in the preamble to the FBO EPS, the Board stated that:

a US intermediate holding company would facilitate an orderly cross-border resolution of a foreign banking organization with large US subsidiaries by providing one top-tier US holding company to interface with the parent foreign banking organization in a single-point-of-entry resolution conducted by its home country resolution authority (which is the preferred resolution strategy of many foreign banking organizations) or to serve as the focal point of a separate resolution of the U.S. operations of a foreign banking organization in a multiple-point-of-entry resolution (which is the preferred resolution strategy of other foreign banking organizations).³¹

While the Board states that one goal of the Proposed Rules is to facilitate MPoE resolutions, the Proposed Rules fail to recognize that a foundational element of a MPoE resolution is the separate resolution of the US operations independent of the parent FBO. Inherent in the MPoE strategy is that the losses from the US operations are not transferred to the foreign parent, but are wholly absorbed within the US enterprise under existing insolvency frameworks. If, as required by the Proposed Rules, the losses from the HSBC Group’s US operations are transferred to HSBC Group’s operations outside the US through Internal TLAC, then there can be no separate MPoE strategy. As a result, the Proposed Rules would essentially impose a SPoE strategy on all FBOs irrespective of the resolution strategy approved by the home country supervisor, the multinational CMG, and the FBO. In order to achieve international comity and cooperation, it is essential for the Board to recognize and respect the resolution strategy that FBOs have developed in consultation with their home resolution authorities, CMG and the Board.

An additional concern, arising from the requirement for Covered IHCs to issue only internal TLAC and LTD, is the concentration of funding for these IHCs when diversification of funding sources is widely considered to be preferable to concentration. The increase in funding concentration also needs to be reviewed in the context of the inter-agency policy SR 10-6 and the FBO EPS, both of which require establishing funding concentration limits that address diversification of funding sources and types, such as exposures to single providers of funds. Moreover, it takes time for any bank to build a debt issuance program so it would be unfortunate if these capabilities were lost at the IHC level, resulting in funding concentrations. There is also the risk that, due to lack of pricing benchmarks, pricing will be dependent upon the requirements of the home country and could result in additional cost to the IHCs that would not be incurred were the IHC permitted to issue external TLAC.

³⁰ 80 Fed. Reg. at 74928.

³¹ 79 Fed. Reg. 17240, 17269 (Mar. 27, 2014) (emphasis added).

We further fully endorse all of the arguments in Section X of the IIB Comment Letter and Sections II.B and II.D of the TCH/SIFMA Comment Letter, which discuss at greater length the need for the final TLAC rules to accommodate MPoE strategies.

The Board may also wish to consider the extra-territorial regulations to which the FBO may be subject to if the final TLAC rules push the statutory resolution event outside of the US, particularly when a viable domestic resolution had been planned for and, in some cases, encouraged. An example would be the draft EU BSR. In the current proposals, non EU-subidiaries of an EU-headquartered group (i.e. FBOs) are exempted from the requirement to split banking and trading activities, provided that these operations do not represent a threat to the financial stability of the EU and its member states. A MPoE strategy with external TLAC issued by the US IHCs would fulfill this condition. However, with the Internal TLAC requirement and contractual conversion trigger, there is a probability that HSBC Group would be required to split banking and trading activities in the US subsidiaries, potentially difficult to accomplish, disruptive operationally and putting the bank at a competitive disadvantage to local peers.

As discussed above, this policy may well “export” financial contagion issues from the US to foreign jurisdictions – indeed, that is the stated intention by pushing the statutory resolution to a foreign jurisdiction. But this stance would seem to be entirely at odds with the principle that countries should not unnecessarily “export” financial contagion. Through the IHC structure, the US has a resolution mechanism that means that issues within US operating banks could be largely contained within the US.

2. The Board should provide greater flexibility to Covered IHCs to determine, in consultation with the Board, which entity within an organization can issue eligible TLAC instruments³²

The Proposed Rules would require all Covered IHCs to issue eligible TLAC themselves. However, this may not be the most efficient structure for all Covered IHCs. For example, although HNAH is the HSBC Group’s Covered IHC, there are other holding companies within the HNAH sub-group that could be a more efficient point of entry for US resolution proceedings. This is an example of the institution-specific implementation of TLAC requirements that the Board should determine is appropriate on a case-by-case basis. In our view, there is substantial benefit – and no harm – for the Board to retain the discretion to tailor the specific requirements and their implementation in consultation with Covered IHCs, their FBO parents and their home and host regulators, if necessary.

B. Policy Principle 2: Pursuant to the principle of national treatment, the final rules should base any TLAC requirements applied to Covered IHCs on the potential risk that the Covered IHC poses to US financial stability, and treat all similarly situated domestic-owned and foreign-owned holding companies consistently and without disproportionately disadvantaging FBOs.

1. The Final Rules Should Reduce Internal TLAC Calibration to Reflect a Covered IHC’s Limited Systemic Risk to US Financial Stability³³

The Board has frequently exercised discretion to tailor supervisory and regulatory requirements to the potential risks posed by FBOs, as well as BHCs, to US financial resiliency. As noted above, the Board

³² This section is responsive to Question 32 in the preamble to the Proposed Rules.

³³ This section is responsive to Questions 25 and 26 in the preamble to the Proposed Rules.

has applied such flexibility in considering resolution strategies under Title I of the Dodd-Frank Act³⁴. We recommend a similar approach be adopted to tailor the TLAC and LTD requirements to the potential systemic risks posed by FBO's US operations to US financial stability. HNAH's systemic risk score is consistent with that of a US regional bank according to a February 2015 paper published in an OFR Brief (see Figure 1). Other evidence exists indicating that the current prudential regulatory treatment of HNAH suggests that it would fit into a lower risk category. For example, HNAH is not in the Board's Large Institution Supervision Coordinating Committee portfolio for institutions "that may pose elevated risks to US financial stability".³⁵ Further, the Proposed Rules correctly do not apply any G-SIB surcharges or the enhanced supplementary leverage ratio requirements to Covered IHCs since these entities have not themselves been designated US G-SIBs and are not the largest companies that pose the most systemic risk to the US.

We agree with the IIB and TCH/SIFMA that the Board should calibrate the TLAC requirements that a Covered IHC should meet in accordance with the level of systemic importance, or lack thereof, of the Covered IHC to the US economy. The Proposed Rules fail to do this because they would require Covered IHCs to issue the same levels of TLAC as Covered BHCs, even where the Covered IHCs are significantly less systemically important to the US economy. As a result, Covered IHCs would be required to comply with onerous and expensive requirements based solely on their affiliation with a FBO, even if their US operations pose no systemic risks to the US and the great majority of the FBO's activities occur outside of the US. The failure to correlate the TLAC requirements to the actual systemic importance of the FBO's US operations creates a competitive disadvantage for FBOs in the US in comparison to their US peer institutions solely on the basis that they are owned by a FBO. Moreover, as indicated previously:

- HNAH operates financially separately from other HSBC Group entities for the purposes of capital, funding, liquidity and resolution and is regulated by the Board and the OCC.
- HBUS, HNAH's largest subsidiary, is a relatively simple bank that is deposit-funded.
- All HSBC Group US operations are under the HNAH IHC, as made clear in relevant Board publications,³⁶ thereby eliminating a potential area of complexity in terms of resolvability.

Furthermore, the conclusion that HNAH's operations do not pose a systemic risk to US financial stability is supported by the current US prudential regulatory treatment of HNAH, which suggests that HSBC Group's US operations fall into a significantly lower risk category than those of the US G-SIBs.³⁷ As

³⁴ Similarly, the Board has used a multi-factor analysis including size, interconnectedness, substitutability, complexity, and cross-jurisdictional activity data in its FR Y-15 report in order to determine which institutions will be subject to its G-SIB capital surcharge. 79 Fed. Reg. 75473 (Dec. 18, 2014).

³⁵ <http://www.federalreserve.gov/bankinforeg/large-institution-supervision.htm>.

³⁶ See "Structure Data for the U.S. Offices of Foreign Banking Organizations" (Board, Sept. 30, 2015), <http://www.federalreserve.gov/releases/iba/201509/bycntry.htm>.

³⁷ As noted previously, HNAH's systemic risk score is consistent with that of a US regional bank. Similarly, HNAH is (i) not in the Board's Large Institution Supervision Coordinating Committee portfolio for institutions "that may pose elevated risks to U.S. financial stability" (ii) not designated as a first wave filer (which is made up of the largest and most complex financial institutions) for purposes of the Board's resolution plan requirements; and (iii) not designated as a US G-SIB by the Board, which evaluates a banking organization's systemic importance on the basis of its attributes in five broad categories: size, interconnectedness, cross-jurisdictional activity, substitutability, and complexity.

indicated in the OFR brief and reflected in Figure 2 above, the systemic risk scores for the eight US G-SIBs range from 1.48 to 5.05 and average 2.77, while HNAH's score is only 0.38.

2. The Board Should Apply a Consistent Methodology in Determining the External and Internal TLAC Levels

a. Balance Sheet Depletion Assumption for Covered IHCs³⁸

The HSBC Group supports the arguments stated in the IIB Comment Letter and Section II of the TCH/SIFMA Comment Letter, to incorporate the same assumption of balance sheet depletion for IHCs that is reflected in the Board's proposed methodology for Covered BHCs.

In the preamble to the Proposed Rules, the Board states that its calibration of internal TLAC is based on the same methodology that it used to determine the levels of external TLAC.³⁹ The Proposed Rules correctly do not apply any external TLAC buffers based on G-SIB surcharges or the enhanced supplementary leverage ratio requirements to Covered IHCs since these entities have not themselves been designated US G-SIBs. However, the Board does not reduce the calibration of internal TLAC to take into consideration an assumption of balance-sheet depletion as it does for the calibration of external TLAC, even though in this respect, Covered IHCs should be treated the same as Covered BHCs. This is because the balance sheet depletion assumption is unrelated to whether an entity is a G-SIB; the assumption that losses will shrink an entity's balance sheet applies whether or not the entity is a G-SIB or a Covered IHC. The non-application of G-SIB surcharges or enhanced supplementary leverage ratios to Covered IHCs reflects the real differences between the types of entity; as would reducing the calibration of internal TLAC to take into assumption of balance-sheet depletion.

There is no explanation in the preamble to the Proposed Rules for why a similar assumption would not be appropriate for the calculation of internal TLAC and we are not aware of a sound basis for applying a different and negative assumption to FBOs.⁴⁰ And in the case of a Covered IHC that employs a MPoE resolution strategy, such as HNAH, taking into account balance sheet depletion is especially important because the Board should apply the same assumptions applied to an entity entering into insolvency proceedings, whether it is a Covered IHC or Covered BHC. In accordance with the arguments put forth in the IIB Comment Letter and the TCH/SIFMA Comment Letter, we believe that as a matter of fundamental fairness, the Board should recalibrate internal TLAC levels taking into consideration the assumption of balance sheet depletion.

b. Eliminating the Standalone LTD Requirement⁴¹

HSBC Group fully supports the arguments contained in both the IIB Comment Letter and the TCH/SIFMA Comment Letter describing why the Board should eliminate the Proposed Rules' minimum LTD requirement.⁴² As we discuss above, MPoE IHCs, such as HNAH, should be able to issue TLAC to third parties as well as to affiliates. However, even for externally issued TLAC, the Board should not require a fixed portion of such TLAC to be in the form of LTD.

³⁸ This section is responsive to Question 26 in the preamble to the Proposed Rules.

³⁹ 80 Fed. Reg. at 74941 ("The proposed internal LTD requirements are based on the capital refill framework discussed above with respect to the proposed external LTD requirements.").

⁴⁰ Please refer to the TCH/SIFMA Comment Letter Annex 1, Section II.B.2: "There is no material difference between covered BHCs and resolution entity IHCs just like a covered BHC."

⁴¹ This section is responsive to Questions 34 and 35 in the preamble to the Proposed Rules.

⁴² IIB Comment Letter, Section III; TCH/SIFMA Comment Letter Annex 1, Section II.B and C.

3. The Board Should Conform the Eligibility Requirements for Internal LTD with Those for External LTD⁴³

If the Board retains the minimum LTD requirements, at a minimum, the Board should eliminate the eligibility criteria that would make such LTD unduly costly and that do not in any way enhance a Covered IHC's resolvability. As we discuss above, MPoE IHCs should be allowed to issue TLAC to third parties on the same terms as Covered BHCs. Under this framework, we believe that MPoE IHCs should be subject to the same eligibility criteria with respect to their externally issued LTD as external TLAC issued by Covered BHCs.

However, if the Board retains the Internal Issuance Requirement for MPoE IHCs, then, at a minimum, it should eliminate the eligibility criteria that are not necessary for resolvability. We support the comments made in the IIB Comment Letter and the TCH/SIFMA Comment Letter that are in favor of eliminating the following eligibility criteria:

- Mandatory contractual conversion trigger;⁴⁴
- Mandatory contractual subordination;⁴⁵ and
- Amortization haircut for LTD with an outstanding maturity between one and two years.⁴⁶

We note that, even if the Board retains the requirement that HNAH and other MPoE IHCs must issue TLAC and LTD solely internally, MPoE IHCs would still bear the full market cost of that LTD because, as we discuss above, it would be priced on an arms-length basis with its parent FBO. As such, the cost of including a contractual conversion trigger would be substantial and reflect the market price for this unprecedented provision.

In addition to the arguments made in the IIB Comment Letter and the TCH/SIFMA Comment Letter, we would add that a contractual conversion trigger is particularly unnecessary for the internal LTD of MPoE IHCs because they are intended under their resolution plans to enter resolution. For example, because HNAH is a resolution entity, its LTD debt is analogous to the LTD of a Covered BHC that would be expected to enter resolution under a SPoE resolution strategy. As the Board explains in the preamble to the Proposed Rules, the whole notion of a minimum level of LTD is meant to "ensure that covered BHCs will have at least a fixed minimum amount of loss-absorbing capacity available to absorb losses upon the covered BHC's entry into resolution."⁴⁷ As a resolution entity, the same is true for HNAH and other MPoE IHCs, so including a contractual conversion trigger in its internal LTD that would convert the internal LTD to common equity outside of resolution proceedings is not necessary. Further, once the resolution entity is in insolvency or resolution proceedings, the conversion of LTD to common equity, and the imposition of losses on the MPoE IHC's creditors would happen by operation of law.

⁴³ This section is responsive to Questions 32 and 33-39 in the preamble to the Proposed Rules.

⁴⁴ IIB Comment Letter, Section IV; TCH/SIFMA Comment Letter Annex 1, Section II.D.3.

⁴⁵ IIB Comment Letter, Section V.F; TCH/SIFMA Comment Letter Annex 1, Section II.D.2

⁴⁶ TCH/SIFMA Comment Letter Annex 1, Section II.C.3.

⁴⁷ 80 Fed. Reg. at 74935.

The Board justifies the need for Covered IHCs to maintain minimum levels of LTD so that the LTD can provide a “fresh source of capital subsequent to failure.”⁴⁸ A contractual conversion trigger for the LTD of a resolution entity would undermine this benefit if it were exercised, because it would be triggered prior to failure or would be unnecessary. Such a provision would, however, increase the cost of compliance with the final rules because the level of supervisory discretion implied by a contractual conversion trigger is considerable and the market is uncomfortable with this level of uncertainty.

4. Tax Implications of Contractual Conversion⁴⁹

As discussed in the IIB Comment Letter, Section IV, and the TCH/SIFMA Comment Letter Annex 1, Section II.D.3, the contractual conversion feature, along with other terms of the internal LTD to be issued by Covered IHCs (including the subordination and lack of acceleration rights), create a substantial risk that the internal LTD will be characterized as equity rather than debt for tax purposes and that, as a result, interest payments on internal LTD would not be tax deductible imposing a direct and significant financial penalty on Covered IHCs, and therefore FBOs, as compared to US BHCs.

Although the determination of whether an instrument is debt or equity for tax purposes is fact-specific and references a variety of factors, the conversion feature is likely to be sufficient on its own to mandate equity treatment. The applicable law requires adequate creditor remedies and other terms intended to ensure that debt always has priority over equity, on both a going-concern and gone-concern basis. This means that the internal LTD would be junior to or, at best, pari passu with an instrument that is treated as equity for tax purposes and, in that context, it is difficult to see how the internal LTD can be treated as debt for tax purposes. In addition, the conversion would occur outside of and in the absence of a regulatory or insolvency proceeding

5. Structured Notes

We support the arguments provided in the TCH/SIFMA Comment Letter on US G-SIBs to include structured notes that are principal protected at par as eligible TLAC instruments and to permanently grandfather these instruments.⁵⁰ We believe that BHCs should be allowed to issue such structured notes as eligible TLAC instruments subject to the terms of bail-in being easily calculated at Point of Non-Viability (for example, contractually based on par value rather than market valuation) and with limits on the number of issues to be allowed from any BHC to avoid complexity. These terms for BHCs should then be applied to IHCs to the extent that they are permitted to issue external TLAC.

⁴⁸ 80 Fed. Reg. at 74931.

⁴⁹ This section is responsive to Questions 38 and 39 in the preamble to the Proposed Rules.

⁵⁰ TCH/SIFMA US G-SIB Comment Letter Annex 1, Section IV.D.